

AIR TRANSPORT MARKET ANALYSIS

DECEMBER 2010

KEY POINTS

- Air travel markets (RPKs) were hit significantly in December by the severe winter weather in Europe and North America, which reduced total traffic by around 1%. Partly due to this adverse impact the year-on-year growth rate slowed to 4.9% in December, compared with the growth rate of 8.2% in November. Fast growth at the end of 2009 also contributed to the apparent slowdown. The year-on-year increase for air freight (FTKs) in December was 6.7%, a higher growth rate than the revised 5.8% reported for November.
- After adjusting for seasonal fluctuations, air travel fell by just under 1% between November and December – due entirely to the severe weather in Europe and North America. If it were not for the severe weather there would have been a further, though modest, increase in air travel volumes in December. But there was certainly a slowdown in the pace of air travel expansion in the final two months of 2010. Until November the 2010 expansion had been trending higher at an annualized growth rate of just under 6%.
- By December 2010 air travel volumes had reached a point 15% above the low of early 2009 and 4% above the pre-recession high of early 2008. Air freight in December was 34% above its low and, though 5% down on early 2010, was still 1% above the pre-recession peak level of early 2008.
- Capacity continues to be introduced at rate quite close to growth in market demand. In fact passenger capacity shrank by more than demand during December. The year-on-year growth of 5.8% in December was more than the 4.9% growth in traffic but that was due to the comparison with fast traffic growth and slow capacity increases in December last year. Passenger load factors, seasonally adjusted, rose between November and December. The same was true on air freight markets. Freight load factors improved during December.
- 2010 as a whole was a year of strong recovery in air travel and air freight markets. For the full year reported passenger traffic increased by an above trend 8.2% and air freight was up by an exceptional 20.6%. Capacity lagged far behind. As a result there was a significant improvement in load factors with the passenger load factor rising by 2.7 percentage points to 78.4% for the full year with the freight load factor up by 5.2% points to 53.8%.
- Momentum going into 2011 did not appear to be particularly strong. However, business confidence and other business travel drivers strengthened at the end of last year. Gains in world trade and a stabilization of air freight volumes point to a further upward leg to the expansion of goods shipped by air. Prospects for 2011 still seem to be consistent with air travel and freight markets expanding close to trend growth of 5-6% this year.

Year on Year Comparison	December 2010 vs. December 2009						YTD 2010 vs. YTD 2009					
	RPK	ASK	PLF	FTK	AFTK	FLF	RPK	ASK	PLF	FTK	AFTK	FLF
Africa	11.7%	10.4%	71.2%	-4.5%	7.6%	24.3%	12.9%	9.6%	69.1%	23.8%	12.1%	26.9%
Asia/Pacific	2.9%	5.4%	76.6%	7.9%	6.9%	65.9%	9.0%	3.6%	77.6%	24.0%	14.3%	65.9%
Europe	3.3%	3.4%	76.9%	3.0%	4.5%	52.2%	5.1%	2.6%	79.4%	10.8%	0.5%	52.1%
Latin America	-1.1%	-2.8%	77.3%	3.8%	-8.9%	49.5%	8.2%	2.9%	76.7%	29.1%	12.6%	44.3%
Middle East	14.1%	13.3%	76.8%	14.7%	14.1%	45.8%	17.8%	13.2%	76.0%	26.7%	15.7%	46.7%
North America	6.7%	8.4%	80.8%	5.2%	7.7%	43.2%	7.4%	3.9%	82.2%	21.8%	6.1%	43.4%
Industry	4.9%	5.8%	77.2%	6.7%	6.7%	53.8%	8.2%	4.4%	78.4%	20.6%	8.9%	53.8%

RPK: Revenue-Passenger-Kilometers; ASK: Available-Seat-Kilometers; PLF: Passenger-Load-Factor; FTK: Freight-Tonne-Kilometers; AFTK: Available Freight Tonne Kilometers; FLF: Freight Load Factor;
 All Figures are expressed in % change Year on Year except PLF and FLF which are the load factors for the specific month.

COMPARING DECEMBER TO NOVEMBER

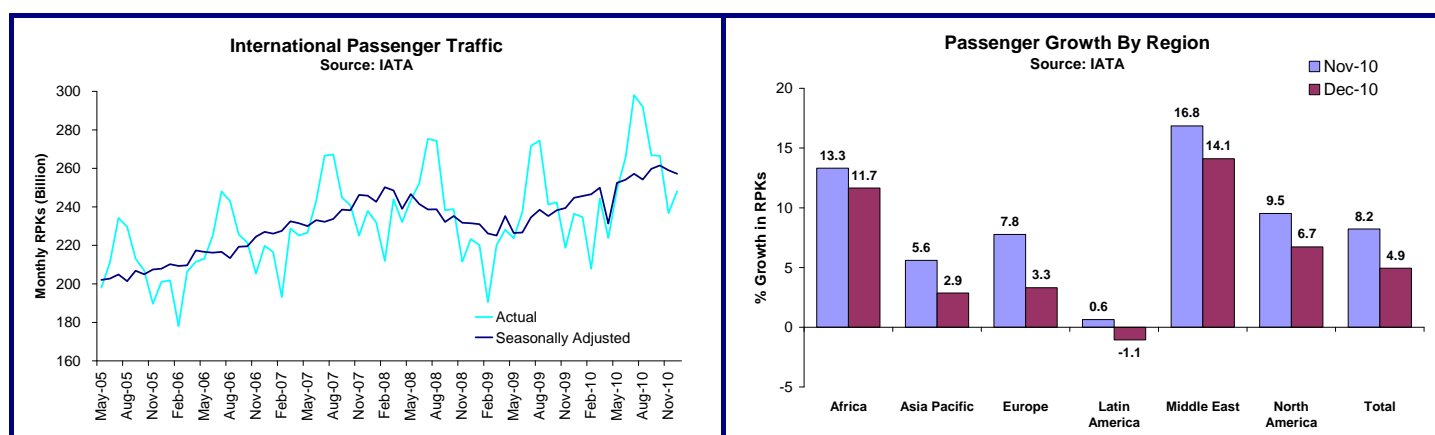
December 2010 vs. November 2010

Month on Month Comparison	RPK	ASK	PLF pt	FTK	AFTK	FLF pt
Africa	1.2%	-0.7%	1.3%	-4.1%	-3.3%	-0.2%
Asia/Pacific	-0.2%	0.2%	-0.3%	1.9%	-0.1%	1.3%
Europe	-1.9%	-3.1%	1.0%	-1.3%	-0.1%	-0.6%
Latin America	-0.6%	-0.4%	-0.2%	-1.3%	-1.4%	0.0%
Middle East	0.3%	-0.1%	0.3%	2.0%	-0.4%	1.1%
North America	0.0%	0.0%	0.0%	5.4%	1.5%	1.6%
Industry	-0.7%	-1.2%	0.4%	1.5%	0.0%	0.8%

Data are seasonally adjusted.
All figures are expressed in % change month on month except, PLF pt and FLF pt which are the percentage point difference between load factors of two consecutive months.

- ↗ On a seasonally adjusted basis whilst passenger traffic declined by just under 1%, freight traffic increased by some 1.5%
- ↗ Adjusting for the effects of the severe winter weather suggests that passenger traffic rose moderately.
- ↗ Europe in particular was affected by the severe winter weather which is reflected in the monthly figures.
- ↗ The bankruptcy of Mexicana continues to have an impact on Latin America although this will continue to diminish.
- ↗ In terms of freight North America was up by some 5.4% although this should be looked at against the November figures where there was a decline of some 7% in FTKs which suggests a timing issue.

AIR TRAVEL VOLUME GROWTH TEMPORARILY DENTED BY WEATHER

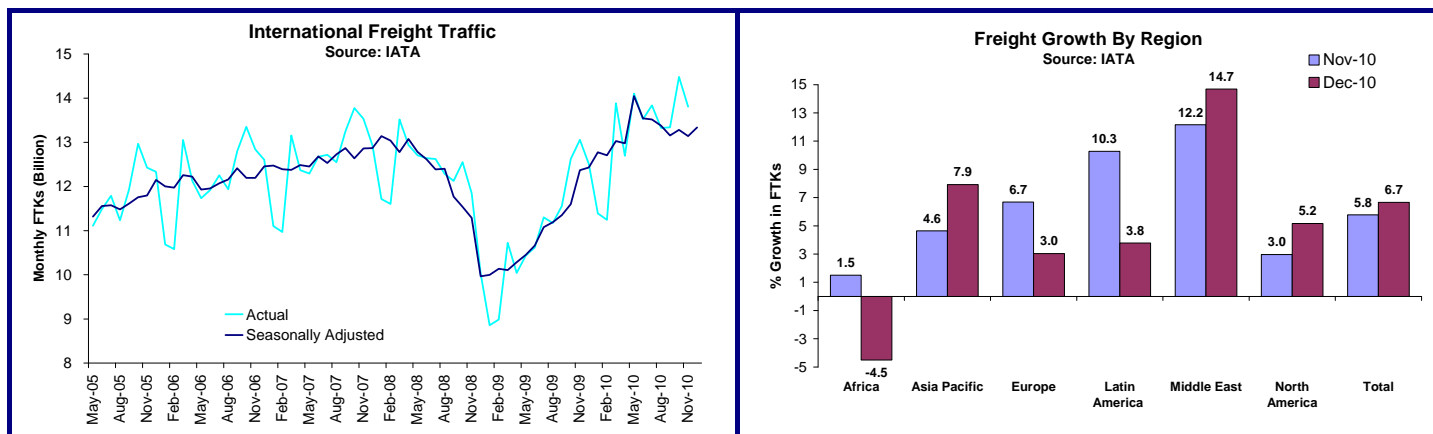


- ↗ International passenger traffic was some 4.9% higher than in December 2009; the slowing in the reported growth rate from the 8.2% for November reflects a number of factors; firstly we estimate that the severe winter weather in Europe and North America reduced the headline figure by about 1%, secondly December's starting point was more demanding in that traffic in December 2009 was some 4.5% up on December 2008's outcome, whilst November 2009 was up by 2.1% on November 2008. Using 2008 as the starting point then in November 2010 traffic was some 10.4% higher than in November 2008 whilst for December, before the weather adjustment traffic was some 9.6% higher, or some 10.6% when we add back the 1% for the weather disruption suggesting that the underlying trend remains in place.
- ↗ The greatest monthly variation was evident in the Asia-Pacific region - however this needs to be set against what was occurring a year ago; In December 2009 passenger traffic was some 8% higher than in December 2008 – for November, the increase over 2008 had been 5.1%. Using the corresponding months in 2008 as the reference point this suggests that in November 2010 traffic was up by just over 11% compared with November 2008 and 11% higher for December 2010 compared with December 2008. – Again still on trend.
- ↗ For the full year passenger traffic was up by 8.2% with the final quarter up by some 7.7% on a reported basis; on a seasonally adjusted basis traffic in the final quarter of 2010 was some 7.4% above the level in the corresponding quarter of 2009.
- ↗ The key features for 2010 are the capacity discipline in the North American market where full year ASKs were up by just 3.9% and, with traffic up by almost twice that amount, this has shown through not only in a sharp

recovery in the financial performance but the prospect of a record outcome for 2010. The passenger load factor at 82.2% for the full year (up from 79.6% in 2009) may prove difficult to maintain if capacity additions accelerate over the period ahead. For the full year traffic was some 7.4% above 2009's total and just over 1% higher than in 2008.

- The growth reported by the Middle East airlines during 2010 is unsurprising given the delivery schedules of the Gulf based airlines in particular; here passenger load factors increased by 3% points to 76.0%. Traffic in both November and December 2010 was some 35% higher than in was in the corresponding months in 2008 which gives some indication of the structural change that is occurring. On an annual basis, traffic in 2010 was some 31% greater than the total for 2008.
- Whilst the monthly figures for Latin America reflect the demise of Mexicana, the reality is that compared with December 2008, the figures for the latest month show growth of some 5%, and for 2010 overall the total is almost 8% more than that reported in 2008, although this includes 7 months of traffic from Mexicana - conversely there are 5 months when Mexicana was not operating.

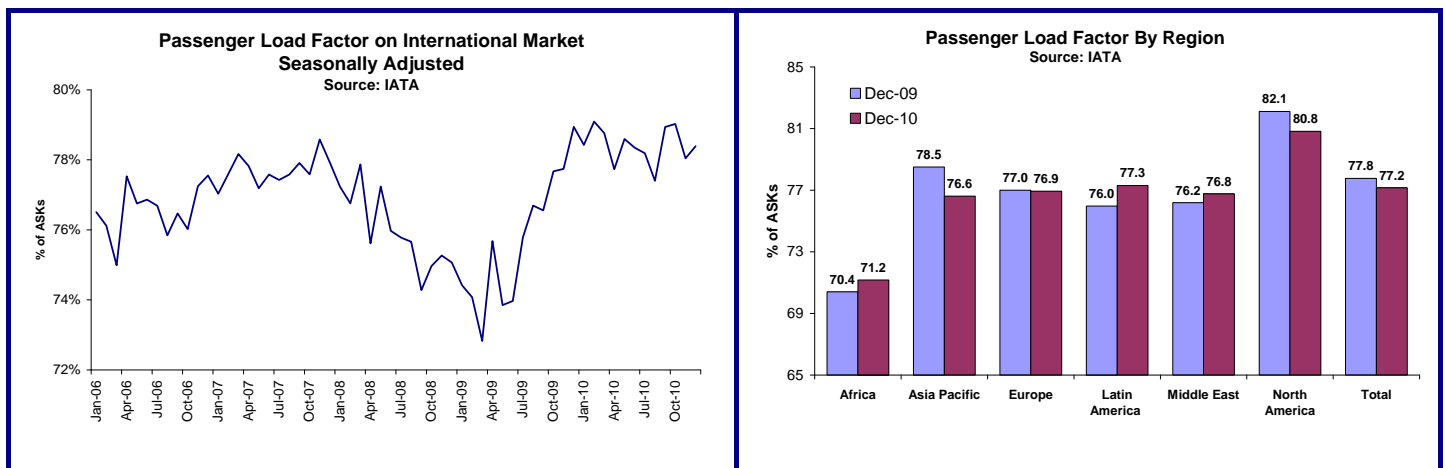
AIR FREIGHT VOLUME GROWTH STABILIZING



- In December International air freight volumes were some 6.7% higher than December 2009 which compares with a growth rate of 5.8% for November; if the reference months are in 2008 then FTKs in December 2010 were a third more than in December 2008 whereas FTKs in November 2010 were 17% above the level reported in November 2008. Just as November might appear to have been an aberration there is a risk that December could be too.
- The regional variation in freight growth rates remains particularly marked however it is necessary to put into perspective the relative size of each region and the respective impacts on industry growth rates; In particular, freight traffic carried by Asia Pacific airlines in volume terms is some 4.2 times that carried by the Middle East airlines; Indeed in December the Asia Pacific Airlines accounted for some 45% of FTKs compared with just over 10% for the Middle East airlines.
- Over the last twelve months all regions have experienced significant variation in the reported freight growth rates; for the industry overall the range has been between 5.8% (November 2010) and 35.2% (May 2010); for the Middle East 12.2% (November 2010) and 38.7% (May 2010); Asia Pacific 4.6% (November 2010) and 39.9% (May 2010); the greatest range of almost 60% points was experienced by the Latin American airlines 3.8% (December 2010 and 63.0% (April 2010). There is an inevitability that reported growth rates will slow as comparisons become more onerous given that in H1 2010 FTKs increased at an average rate of almost 29%.
- So much for the history, what about the future and here there are several factors at play; there are some concerns over the strength of consumer demand and not just in the developed world where fundamental demand remains an issue; however underlying production data still suggests a phase of expansion for emerging economies which will provide support for further growth in freight markets, although at closer to 5-6% historical trend levels than the faster rates seen in the post recession period so far.

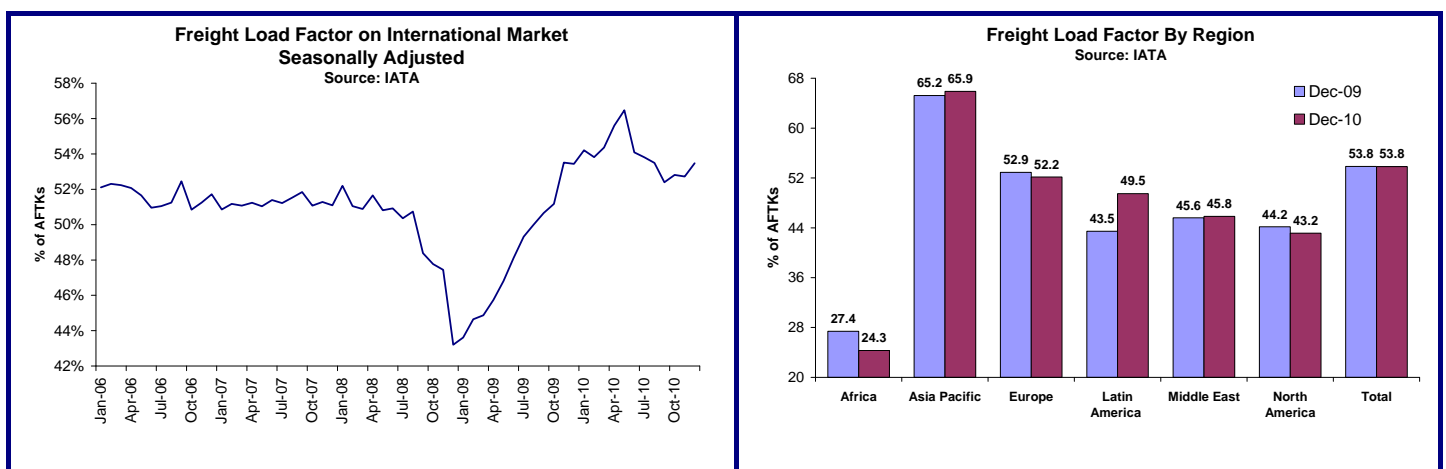
PASSENGER LOAD FACTORS REMAIN IN STABLE RANGE

- Whilst passenger load factors in December at the industry level remained within the 77-79% range, there continues to be a marked variation across the regions; for the North American carriers passenger overall load factors of almost 81% for December, and just over 82%, for the full year are close to those seen in the so-called LCC segment of the market; however the capacity discipline associated with these load factors has been clearly evident in the financial performances of most airlines in the region. The risk is now is that to accommodate growth, too much capacity is introduced/re-introduced too quickly against a still uncertain background.
- Whilst the load factor tells us how much capacity has been used, the more useful figure is the gap between the achieved load factor and the breakeven load factor; In our latest forecasts which also include the effects of freight, we expect that there will have been a slight decline in the breakeven load factor in 2010 compared to 2009, with the main driver of profitability being volumes (as well as a partial recovery in premium traffic); however for 2011 we currently expect the break even load factor to increase and the achieved load factor to decline - each 0.1% change in the gap between the achieved load factor and breakeven has the potential to swing the result by some \$800m underlining how fine the balance is ultimately between supply, demand and yields.



FREIGHT LOAD FACTORS SETTLING?

- After a period of rapid recovery and then a small decline, freight load factors have settled down at a slightly higher level than before the downturn; yield remains a key driver in minds of airline cargo departments.



FURTHER ANALYSIS AND DATA

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